Supreme Court, U.S.
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No.

In the Supreme Court of the United States

APPLIED COMPANIES,

Petitioner,

v.

FRANCIS J. HARVEY,
Secretary of the Army,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Federal Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

At issue is the vitality of the Supreme Court's rule limiting issues absent a cross-appeal; specifically:

May a court of appeals entertain an appellee's affirmative defense to liability, rejected at trial level, where the appellee has not cross-appealed?

PARTIES TO THE PROCEEDING
(and Corporate Disclosure Statement)

Petitioner

Applied Companies is a California corporation, which has not issued shares to the public. No publicly held corporation owns any of Applied Companies' stock.

Respondent

Respondent is the United States of America acting by and through the Department of the Army, Francis J. Harvey, Secretary.

TABLE OF CONTENTS

Page

QUESTION PRESENTED i

PARTIES TO THE PROCEEDING i

TABLE OF CONTENTS iii

TABLE OF AUTHORITIES v

OPINIONS BELOW 1

BASIS FOR JURISDICTION 1

REGULATION INVOLVED 2

STATEMENT OF THE CASE 2

ARGUMENT FOR GRANTING THE WRIT 6

A. THE FEDERAL CIRCUIT'S DECISION FLOUTS AN "INVETERATE AND CERTAIN" RULE THAT LIMITS ISSUES ABSENT A CROSS-APPEAL 6

B. THE FEDERAL CIRCUIT'S DECISION FLOUTS THE CROSS-APPEAL RULE IN ORDER TO CONTINUE THAT COURT'S PATH OF DISCARDING COMMERCIAL CONTRACT LAW, CONTRARY TO SUPREME COURT INSTRUCTIONS TO APPLY THAT LAW 9

CONCLUSION 14

APPENDIX

Appendix A - Federal Circuit Order Denying Rehearing of 9/12/06 . . . . . 1a

Appendix B - Federal Circuit Errata Sheets of 8/23/06 and 7/14/06 and Federal Circuit Opinion of 7/14/06 . . . . . 2a

Appendix C - Federal Circuit Judgment of 7/14/06 . . . . . 14a

Appendix D - Armed Services Board of Contract Appeals Opinion of 11/2/04 . . . . . 15a

Appendix E - Armed Services Board of Contract Appeals Opinion on Appellant's Motion for Reconsideration of 6/13/05 . . . . . 85a

TABLE OF AUTHORITIES

Page

Cases

B.F. Goodrich Co. v. United States,
398 F.2d 843 (Ct.Cl. 1968) 12

Brownlee v. Dyncorp,
349 F.3d 1343 (Fed.Cir. 2003) 3

El Paso Natural Gas Co. v. Neztsosie,
526 U.S. 473, 119 S.Ct. 1430,
143 L.Ed.2d 635 (1999) 6, 7

Lynch v. United States,
292 U.S. 571, 54 S.Ct. 840,
78 L.Ed. 1434 (1934) 12

Mobil Oil Exploration and Producing, Southeast, Inc.
v. United States,
530 U.S. 604, 120 S.Ct. 2423,
147 L.Ed.2d 528 (2000) 12

Morley Constr. Co. v. Maryland Casualty Co.,
300 U.S. 185, 57 S.Ct. 325,
81 L.Ed. 593 (1937) 7, 8

Perry v. United States,
294 U.S. 330, 55 S.Ct. 432,
79 L.Ed. 912 (1935) 12

TEG-Paradigm Environmental, Inc. v. United States,
Federal Circuit No. 06-5007 (September 29, 2006) . 13

United States v. ITT Continental Baking Co.,
420 U.S. 223, 95 S.Ct. 926,
43 L.Ed.2d 148 (1975) 4, 7, 8

United States v. National Exchange Bank of Baltimore, Md.,
270 U.S. 527, 46 S.Ct. 388,
70 L.Ed. 717 (1926) 12

United States v. Winstar Corp.,
518 U.S. 839, 116 S.Ct. 2432,
135 L.Ed.2d 964 (1996) 12

Statutes

28 U.S.C. §§ 1254(1) and 2106 1
41 U.S.C. § 607 . . . . . 2, 3

Rules

FRAP 4(a)(3) 3
FRAP 40(a)(1) 1

Regulations

48 CFR (FAR) § 48.102 11
48 CFR (FAR) § 52.248-1 . . . . . 2, 9

Other Authorities

Graham, "Departing From *Hadley*: Recovering Lost Profits on Collateral Undertakings in Suits Against The Government,"
35 Pub. Cont. L.J. 43 (2005) 14

Johnson, "Interpreting Government Contracts: Plain Meaning Precludes Extrinsic Evidence and Controls at the Federal Circuit,"
34 Pub. Cont. L. J. 635 (2005) 13

Restatement of Contracts (2d) 11, 12, 13, 14

PETITION FOR WRIT OF CERTIORARI

OPINIONS BELOW

Armed Services Board of Contract Appeals:

Applied Companies, ASBCA Nos. 50593, 52102, 99-2 BCA ¶ 30,554 (on cross-motions for summary judgment).

Applied Companies, ASBCA No. 50593, 04-2 BCA ¶ 32,786 (on the merits).

Applied Companies, ASBCA No. 50593, 05-2 BCA ¶ 32,986 (on motion for reconsideration).

Federal Circuit Court of Appeals:

Applied Companies v. Harvey, 456 F.3d 1380 (2006)

BASIS FOR JURISDICTION

The judgment and opinion of the United States Court of Appeals for the Federal Circuit were entered and issued on July 14, 2006. Applied Companies filed a timely petition for panel rehearing on August 17, 2006, within the 45 days allowed by FRAP 40(a)(1). Substantive changes to the Federal Circuit's opinion were made by "errata" dated August 23, 2006. The petition for panel rehearing was denied by order dated September 12, 2006. This petition for certiorari is filed within 90 days of that order. The Supreme Court's jurisdiction is invoked pursuant to 28 U.S.C. §§ 1254(1) and 2106.

REGULATION INVOLVED

Federal Acquisition Regulation (FAR) 48 CFR Part 48 – "Value Engineering" and 48 CFR § 52.248-1, contract clause entitled "Value Engineering", pertinent portions of which are set out in the Appendix pp. 17a-20a.

STATEMENT OF THE CASE

Military-specification air conditioners come in five sizes. Applied Companies contracted with the United States Army to supply air conditioners in the 36,000 BTU size. The contract included the standard "Value Engineering" (VE) clause, 48 CFR (FAR) § 52.248-1. Applied submitted and the government accepted a value engineering change proposal (VECP). The VE change reduced the costs of air conditioners by $2,979 apiece. Appendix pp. 40a-45a (Finding 18).

The VE clause provides that a contractor is to receive a 50% share of three years' savings on future contracts for "essentially the same item." Applied claimed a 50% share of savings on military-specification air conditioners in five sizes on grounds that all five were "essentially the same." The government asserted a defense of accord and satisfaction and denied liability for any future contract savings. That defense was based on the wording of bilateral contract modification P9, which conditionally accepted the VECP (subject to testing).

Applied's claim was decided by the Armed Services Board of Contract Appeals (ASBCA) pursuant to the Contract Disputes Act, 41 U.S.C. § 607. The ASBCA's decision,

under the heading "Entitlement,"[1] denied the Government's accord-and-satisfaction defense, and decided that the contractor was entitled to share in future contract savings. Appendix pp. 48a-55a. Under the heading "Quantum," the ASBCA awarded the contractor $1,000,947, as its share of savings on future contracts for 36,000 BTU air conditioners. The ASBCA plurality declined to award a share in future contract savings for military-specification air conditioners in the other four sizes on grounds that the contractor had failed to carry a burden to prove the dollar quantum of savings on each of those other "configurations" of air conditioners. Appendix pp. 63a and 84a.

Pursuant to 41 U.S.C. § 607(g)(1)(A), Applied appealed the ASBCA's decision to the Federal Circuit Court of Appeals. Applied's brief presented and argued the issues whether the ASBCA applied the correct law in determination of quantum.

The government did not appeal pursuant to 41 U.S.C. § 607(g)(1)(B)[2] or file a cross-appeal pursuant to FRAP 4(a)(3). But in appellee's brief the government argued that in modification P9 "Applied Companies Abandoned Any Claim

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[1] It is the ASBCA's long-standing practice to bifurcate its cases into phases of "entitlement," meaning liability, and "quantum," meaning dollar amount of the claimant's recovery. See e.g. Brownlee v. Dyncorp, 349 F.3d 1343, 1347-1349 (Fed.Cir. 2003).

[2] The Contract Disputes Act, 41 U.S.C. § 607(g)(1), gives both the contractor and the government 120 days to appeal to the Federal Circuit. Applied's notice of appeal was filed 58 days after the date of the ASBCA's order denying reconsideration. Therefore the government had plenty of time after notice of Applied's appeal to file its own appeal.

For Compensation Based On Other Contracts" and that, "the board erred in refusing to enforce the plain meaning of ... modification [P9]."[3] Applied's reply brief argued that, absent a cross-appeal, the government's argument of error in the ASBCA's adjudication of entitlement, rejecting the government's affirmative defense, was not cognizable by the court of appeals.

Without acknowledging the cross-appeal rule, the Federal Circuit entertained the appellee's argument that the ASBCA's adjudication of the affirmative defense to liability was error, held that the appellant was not entitled to any recovery, and "affirmed" an award of $1 million on grounds that the correct award was zero. The Federal Circuit's decision is based on that court's interpretation of mod P9, in disagreement with the ASBCA:

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[3] The government's appellee's brief conceded that the ASBCA's quantum decision was "flawed" and resorted to the argument that Applied "abandoned" its right to share in any future contract savings as an "alternative basis for affirming the board." Brief for Appellee dated January 27, 2006, pp.26-27. Compare with respondent's arguments in United States v. ITT Continental Baking Co., infra.

"... we hold that mod P9 and mod P15,[4] read together harmoniously, clearly provide that Applied is not entitled to a share in future savings.

....

"Because the agreement between Applied and the Army provided unambiguously that Applied was not entitled to share in any future savings, the Board correctly declined to award Applied a share of future savings for additional AC models. Accordingly, the decision of the Board is AFFIRMED." Emphasis added. Appendix pp. 11a and 13a.

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[4] Contract modification P15 was a unilateral modification not signed by the contractor. The government did not argue that modification P15 was part of the parties' agreement. The Federal Circuit's "reading" of modification P15 into the parties' agreement was done sua sponte. The Federal Circuit's original opinion stated that the parties' agreement consisted of mod P9 and "... mod P15, which unconditionally accepted the VECP." After Applied filed a petition for panel rehearing on August 17, 2006, noting the inaccuracy of the court's characterization of P15, the Federal Circuit issued an "errata" dated August 23, 2006 which made substantive changes to the original decision including replacement of the court's characterization of mod P15 with "... mod P15, which definitized mutually agreed upon cost savings data in accordance with Applied Companies' fax of December 20, 1991." Appendix p. 2a.

ARGUMENT FOR GRANTING THE WRIT

A. THE FEDERAL CIRCUIT'S DECISION FLOUTS AN "INVETERATE AND CERTAIN" RULE THAT LIMITS ISSUES ABSENT A CROSS-APPEAL.

By entertaining an appellee's argument attacking the trial tribunal's ruling against an affirmative defense, without a cross-appeal, and by allowing that defense as the basis for decision, the Federal Circuit has so far departed from the accepted and usual course of judicial proceedings as to call for an exercise of the Supreme Court's supervisory power.

Repeated Supreme Court decisions establish the principle that "[a]bsent a cross-appeal, an appellee may 'urge in support of a decree any matter appearing in the record, although his argument may involve an attack upon the reasoning of the lower court,' but may not 'attack the [lower court's] decree with a view either to enlarging his own rights thereunder or of lessening the rights of his adversary.' [Citations omitted.]" El Paso Natural Gas Co. v. Neztsosie, 526 U.S. 473, 119 S.Ct. 1430, 1434-1435, 143 L.Ed.2d 635 (1999). In its last statement of the cross-appeal rule, the Supreme Court took the trouble to state that it had "repeatedly affirmed" the rule, that it was recognized "as early as 1796," and that "more than 60 years ago we spoke of it as 'inveterate and certain.'" Ibid, 526 U.S. at 479-480, 119 S.Ct. at 1434-1435.

In this case, without a cross-appeal, the Federal Circuit entertained and adopted an argument that revived an affirmative defense to any liability which the appellee had lost below. The Federal Circuit thereby flouted the Supreme Court's rule without even acknowledging its existence (even though the rule was invoked in the appellant's reply brief).

It is no answer to the cross-appeal rule to assert that the appellee accepted the judgment below and therefore did not seek to lessen the rights won by his adversary. That is no answer because the rule operates to limit issues; it "is meant to protect institutional interests in orderly functioning of the judicial system, by putting opposing parties and appellate courts on notice of the issues to be litigated and encouraging repose of those that are not." El Paso Natural Gas Co. v. Neztsosie, supra, 526 U.S. at 481-482, 119 S.Ct. at 1436. The issue-specific nature of the rule is illustrated in Morley Constr. Co. v. Maryland Casualty Co., 300 U.S. 185, 191, 57 S.Ct. 325, 81 L.Ed. 593 (1937) (which is cited in El Paso Natural Gas, supra), in which the plaintiff-appellee had sought alternative forms of relief, lost one and won the other, and did not cross-appeal. The Supreme Court reversed a court of appeals' reinstatement of the relief that was lost because "where only one party appeals the other is bound by the decree in the court below and he cannot assign error in the appellate court ..." 300 U.S. at 191, 57 S.Ct. at 328. In Applied's case, the appellee government succeeded with the assignment that "the board erred by refusing to enforce the plain meaning of the relevant paragraphs of modification P00009" (by which paragraphs, the government argued, "Applied Companies abandoned any claim for compensation based on other contracts"). Brief for appellee dated January 27, 2006, pp.42-43. The reasoning that an appellee, without a cross-appeal, can re-argue a lost defense if he is willing to accept the end result has been attempted and specifically rejected by the Supreme Court. In United States v. ITT Continental Baking Co., 420 U.S. 223, 95 S.Ct. 926, 43 L.Ed.2d 148 (1975), ITT had been held liable for a single violation penalty. The Government appealed arguing for a continuing violation and daily penalties. At the Supreme Court, ITT did not cross-petition for certiorari but argued that

there had been no violation. The Court would not hear that, stating:

> "Respondent [ITT] recognizes that, not having cross-petitioned, it cannot attack the judgment insofar as it sustained the findings of violations and imposed penalties for violations. [Citations, including Morley Constr. Co., supra, omitted.] Respondent argues that it may nevertheless seek to sustain the Court of Appeals' limitation on the penalties on the theory that no penalty should have been awarded at all. Ordinarily however ... we do not entertain a challenge to a decision on the merits where the only petition for certiorari presents solely a question of the remedy granted for a liability found to exist, even if the respondent is willing to accept whatever judgment has already been entered against him." 420 U.S. at 225 n.2., 95 S.Ct. at 929 n.2.

The Federal Circuit's decision rides over the Supreme Court's "inveterate and certain" rule of limitation of issues on appeal, without even acknowledging that rule. The Federal Circuit's decision usurps the authority to substitute that court's own determination of liability and of an affirmative defense in a case in which a trial tribunal's determination of those matters was not appealed. The Supreme Court should exercise its supervisory power to reverse that usurpation and confirm the vitality of the cross-appeal rule.

B. THE FEDERAL CIRCUIT'S DECISION FLOUTS THE CROSS-APPEAL RULE IN ORDER TO CONTINUE THAT COURT'S PATH OF DISCARDING COMMERCIAL CONTRACT LAW, CONTRARY TO SUPREME COURT INSTRUCTIONS TO APPLY THAT LAW.

The gravamen of the Federal Circuit's decision is that court's interpretation of the parties' written agreement conditionally accepting Applied's VECP. That agreement, modification P9, included:

> "It is mutually agreed that there will be no future contract sharing provisions."

and

> "This price adjustment is an estimate ... the savings are subject to negotiation and final adjustment ... Further, it is mutually agreed that the negotiated settlement method shall be the 'Lump-Sum Settlement Method.'" Appendix p. 29a.

The VE clause's provision for a "lump sum" applies only to future contract savings and is an alternative to "a series of payments over time as future contracts are awarded". 48 CFR § 52.248-1, "Value Engineering," ¶ (i)(4).[5] The ASBCA interpreted mod P9 to mean that there was no need to provide for future contract sharing provisions because the parties agreed to discharge the future savings in a single lump sum. Appendix p. 52a. Rejecting (and mischaracterizing)

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[5] "When the Government wishes and the Contractor agrees, the Contractor's share of future contract savings may be paid in single lump sum rather than in a series of payments over time as future contracts are awarded."

that interpretation, the Federal Circuit held that the "lump sum" language adopted by the parties in their agreement was "irrelevant" and meaningless:

> "The Board also found mod P9's language that 'the negotiated settlement method shall be the Lump-Sum Settlement Method' to contradict[6] language indicating that Applied would not be entitled to future savings, because the VE clause only mentions a lump-sum settlement method as an option with future contract savings. [Emphasis in original.]
>
> ....
>
> The inclusion in mod P9 of language referring to the lump-sum payment method was, at most, irrelevant. ... Accordingly, we hold that mod P9 and mod P15, read together harmoniously clearly provide that Applied is not entitled to a share in future savings." Appendix pp. 10a-11a. Emphasis added.

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[6] The Board made no such "finding" or conclusion of contradiction. To the contrary, the Board interpreted mod P9 harmoniously and coherently:

> "... a lump sum adjustment was the agreed procedure. Therefore there would be no provision for future savings by way of royalties as future AC units were procured. Accordingly there was no need for 'future contract sharing provisions' in the modification." Appendix p. 52a.

The Federal Circuit's interpretation[7] offends a basic canon of contract interpretation as set forth in *Restatement of Contracts (2d)*:

> "§ 203. Standards of Preference in Interpretation
>
> ....
>
> "(a) an interpretation which gives a reasonable, lawful, and effective meaning to all the terms is preferred to an interpretation which leaves a part unreasonable, unlawful, or of no effect;"

It is hard to imagine an interpretation that would more offend that rule than the Federal Circuit's procrustean expedient of simply lopping off a perfectly comprehensible sentence – which bears precisely on the subject of a signed agreement – as "irrelevant."

The Federal Circuit's decision offends another fundamental rule of contract law: interpretation against the draftsman. In a finding of fact that is final, the ASBCA found that mod P9 was "drafted by the government." Appendix pp. 26a-27a, Finding 11. The *Restatement of Contracts (2d)* provides:

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[7] No Government representative testified that the government held or relied on an interpretation like the Federal Circuit's. No government representative testified to an intention that the contractor would waive, release or exchange its VE clause right to a share in future contract savings. Since 48 CFR (FAR) § 48.102 directs that "Agencies shall ... provide contractors a fair share of the savings on accepted VECPs" it is questionable whether agency contracting officials would have had authority to extract a waiver of the contractor's share.

> "§ 206. Interpretation Against the Draftsman
>
> In choosing among the reasonable meanings of a promise or agreement or a term thereof, that meaning is generally preferred which operates against the party who supplies the words or from whom a writing otherwise proceeds".

That rule was held, by the Federal Circuit's predecessor court, to apply specifically to the VE clause. B.F. Goodrich Co. v. United States, 398 F.2d 843, 847 (Ct.Cl. 1968) ("Since this [VE] clause was drafted by the Government, it should be read against the defendant.") But the Federal Circuit's decision "interprets" the parties' agreement in a manner exceedingly adverse to the party who did not draft the agreement – as a complete forfeiture of that party's VE clause right to share in millions of dollars of future contract savings. Those actions of the Federal Circuit in this case are further steps on the path taken by that court to discard established commercial contract law, especially as set out in the *Restatement*.

It is a principle, often restated by the Supreme Court, that contracts of the United States are subject to the same law that governs the contracts of private parties. United States v. National Exchange Bank of Baltimore, Md., 270 U.S. 527, 534, 46 S.Ct. 388, 389, 70 L.Ed. 717 (1926) ("The United States does business on business terms"); Lynch v. United States, 292 U.S. 571, 579, 54 S.Ct. 840, 843, 78 L.Ed. 1434 (1934); Perry v. United States, 294 U.S. 330, 352, 55 S.Ct. 432, 435, 79 L.Ed. 912 (1935); United States v. Winstar Corp., 518 U.S. 839, 895, 116 S.Ct. 2432, 2464-65, 135 L.Ed.2d 964 (1996). In Mobil Oil Exploration and Producing, Southeast, Inc. v. United States, 530 U.S. 604, 607, 120 S.Ct. 2423, 2429, 147 L.Ed.2d 528 (2000), the Supreme Court again reaffirmed the principle and noted "The

Restatement of Contracts reflects many of the principles of contract law that are applicable to this case."

In Applied's case the Federal Circuit gave not even a nod to the *Restatement's* principles of "effective meaning to all terms" and "interpretation against the draftsman," §§ 203(a) and 206, above. That is all of a piece with the Federal Circuit's path away from established contract law, as noted in commentary: Johnson, "Interpreting Government Contracts: Plain Meaning Precludes Extrinsic Evidence[8] and Controls at the Federal Circuit," 34 Pub. Cont. L. J. 635 (2005). (The Circuit has not explained its reasons for rejecting the *Restatement (Second)*'s rules of contract interpretation. Notwithstanding the Supreme Court's insistence that the general law of contracts governs federal contracts, the Circuit

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[8] The Federal Circuit has recently restated its " plain meaning" and "extrinsic evidence" rules in TEG-Paradigm Environmental, Inc. v. United States, No. 06-5007 (September 29, 2006), Slip Op. pp. 14-16, which asserts that "extrinsic evidence may not be used to interpret an unambiguous contract provision." Slip Op. at 15. That rule is directly contra *Restatement* § 212, Comment b, "*Plain meaning and extrinsic evidence*" which includes: "Any determination of meaning or ambiguity should only be made in light of the relevant evidence of the situation and relations of the parties ... preliminary negotiations and statements made therein ..." and Comment c: "The rule of [§ 212] Subsection (1) permits reference to the negotiations of the parties, including statements of intention ... so long as they are used to show the meaning of the writing." Emphasis added. In Applied's case, the Federal Circuit characterized the testimony of a government official (and Army procuring activity Deputy Commander) to the Army's intention as "parol." Appendix p. 11a. (Compare with *Restatement* § 213 "(Parol Evidence Rule)" ("A binding integrated agreement discharges prior agreements to the extent that it is inconsistent with them." Emphasis added.))

may see no need to explain ...") Emphasis added. 34 Pub. Cont. L.J. at 636 and 672.[9]

CONCLUSION

Certiorari should be granted and the Federal Circuit's decision should be reviewed and summarily reversed because that decision deviates from established law limiting issues cognizable by a court of appeals. The Federal Circuit's arrogation of power to decide issues excluded by the long-standing cross-appeal rule calls for use of the Supreme Court's supervisory power. The Federal Circuit's decision unmistakably signals that, if not reined in, that court will honor no such constraint on its power to entertain any issues at all.

In addition, the Federal Circuit's decision in this case signals that that court will continue on its path of ignoring established contract law, especially the *Restatement of Contracts* 2d, and of fashioning wholly new law for contracts of the government. It would be appropriate for the Supreme Court also to rein in the Federal Circuit's deviation from established contract law.

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[9] See also Graham, "Departing From *Hadley*: Recovering Lost Profits on Collateral Undertakings in Suits Against The Government," 35 Pub. Cont. L.J. 43 (2005). ("In suits against the Government *Hadley [v. Baxendale, 156 Eng. Rep. 154 (1854)]* is subject to an important qualification. ... the Federal Circuit generally holds that lost profits must flow from the contract with the Government ... This rule ... constitutes a stark departure from *Hadley* and the common law of contracts." pp.59-60.)

Respectfully submitted,

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